

Economic Review Meeting

September 4, 2014



Washington State
Economic and Revenue Forecast Council

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WASHINGTON STATE
ECONOMIC AND REVENUE FORECAST COUNCIL

AGENDA

ECONOMIC REVIEW MEETING

September 4, 2014
1:00 p.m.

- Approval of meeting minutes: June 17, 2014
- Budget Outlook: Criteria for resources assumed in Outlook (continued)
- Presentation of economic outlook and revenue collection experience

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STATE OF WASHINGTON

ECONOMIC AND REVENUE FORECAST COUNCIL

Capitol Plaza Building, PO Box 40912 □ Olympia, Washington 98504-0912 □ (360) 534-1560

Meeting Minutes Revenue Review

June 17, 2014

John L. O'Brien, Hearing Room B

Economic and Revenue Forecast Council

Members Present

Ross Hunter, House of Representatives, Chair
Andy Hill, Senate (via phone)
Jim Hargrove, Senate
Terry Nealey, House of Representatives (via phone)
Carol Nelson, Department of Revenue
David Schumacher, Office of Financial Management

Staff

Steve Lerch, ERFC
Richard Ramsey, Senate
Melissa Palmer, House
Pam Davidson, OFM

Call to Order

The meeting was called to order by Representative Hunter at 2:01 p.m.

Motion

Senator Hargrove made a motion to approve the meeting minutes from the February 19, 2014, May 1, 2014 and June 5, 2014 meetings, seconded by Representative Hunter. Council approved the motion at 2:02 p.m.

Presentation on Budget Outlook

Budget Outlook Work Group members presented criteria options for resources assumed in the state's budget outlook. Discussion ensued between Council members and work group members regarding the criteria. Representative Hunter requested that this be discussed further at the next Council meeting as consensus was not attainable at this time.

Presentation on Revenue Forecast

Dr. Lerch presented information on the final economic and revenue forecast. Dr. Lerch summarized the forecast changes. Discussion ensued regarding part-time and full-time employment in the state.

Motion

Senator Hargrove moved, seconded by Representative Hunter, that the baseline revenue forecast be adopted. Council unanimously approved the motion at 2:52 p.m.

Adjournment

Meeting adjourned at 2:52 p.m.

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Criteria Options for Resources Assumed in Outlook

At the 1 May 2014 Outlook meeting, the ERFC directed the workgroup to develop options regarding criteria for when resources may be reflected in the outlook and present these to the ERFC at the June 17th meeting.

Background:

The Outlook adopted on May 1, 2014 reflects \$52.7 million in resources in the 2015-17 biennium related to the Life Sciences Discovery Fund (LSDF). The 2014 Supplemental budget includes language expressing the Legislature's intent to direct the resources from the strategic contributions to the Education Legacy Trust Account (ELTA) rather than the LSDF in the 2015-17 biennium. The 2014 Supplemental budget also eliminated the strategic contribution deposit into the LSDF in the current biennium; however, this was vetoed.

Criteria Options:

The options below for defining the criteria regarding when resources can be reflected in the Outlook are based on the following general premises:

- Impacts of separate legislation that address transfers/redirections to and from funds covered by the Outlook will be included in the Outlook, as prescribed by the legislation.
- Resources reflected in the Outlook must be available. For instance, if the budget includes a one-time fund transfer, leaving the fund with no balance, then the transfer may not be reflected as an available resource in future years in the Outlook.
- The Legislature must specifically identify the fund affected by the transfer/redirection.

Possible Criteria/Options for defining when resources may be reflected in the Outlook:

Option 1

If a redirection/transfer is addressed in the operating budget, the Outlook may reflect the continuation of the policy adopted in the operating budget, provided:

- a. There is Legislative intent language addressing the resource/transfer in the budget;
- b. There is a projected balance in the fund in the ensuing biennium, including balances that result from changes in appropriations that result in resources in the succeeding fiscal period; and
- c. The assumptions in the Outlook are tied to policy in the biennial budget. The outlook cannot assume a policy that has not been enacted in the current budget or separate legislation.

Example: If this option were adopted, the resources in the 2014 Supplemental Budget Outlook would not reflect any resources related to the strategic contribution because the section in the operating budget that eliminated the 2015 strategic contribution transfer to the LSDF was vetoed. Therefore, the intent language affecting the 2015-17 biennium is no longer linked to policy in the current biennial budget. This is a different approach than the one used for the Outlook adopted by the ERFC on May 1, 2014; that Outlook includes resources related to the strategic contribution related to the 2015-17 intent language, as it was not vetoed.

Option 2

If a redirection/transfer is addressed in the operating budget, the Outlook may reflect the continuation of the policy adopted in the operating budget, provided:

- a. There is Legislative intent language addressing the resource/transfer in the budget;

Criteria Options for Resources Assumed in Outlook

- b. There is a projected balance in the fund in the ensuing biennium, including balances that result from changes in appropriations that result in resources in the succeeding fiscal period;
- c. The assumptions in the Outlook are linked to policy in the current biennial budget; and
- d. The policy does not assume a permanent elimination/redirection. However, if the policy assumes a permanent elimination/redirection of a resource and there is statute regarding the resource – the change would need to be made to statute.

Examples: (A) The strategic contribution is deposited into the Tobacco Settlement Account. Per statute, the Legislature is directed to transfer the amount associated with the strategic contribution from the Tobacco Settlement Account to the Life Sciences Discover Fund.

The 2014 Supplemental budget modified the transfer to eliminate the strategic contribution deposit to the LSDF – this was vetoed. Because the budget ended the funding for the LSDF, in order to include the resource in the Outlook under this option, the Legislature would need to amend the LSDF statute.

However, if the Legislature did not eliminate the program, it could have expressed its intent to continue a reduced level of funding for the LSDF without changing the statute regarding the LSDF transfer. During the 2009-11, 2011-13, and 2013-15 biennium, the Legislature transferred part of the strategic contribution to the LSDF but not the entire amount.

(B). The current budget could reduce the authorization for appropriated accounts (e.g. Wildlife Account, State Toxics Control Account) that are not covered by the outlook, thereby creating sufficient fund balances for assumed transfer in the outlook for the succeeding fiscal period. The Legislature could express its intent to transfer resources in the succeeding biennium in the budget and reflect these resources in the Outlook. Absent intent language, the resources would be assumed to remain in the account, rather than be available in the accounts covered by the outlook.

Option 3

In order to assume a resource related to a redirection/transfer in a timeframe beyond the budget, the statute would need to be amended. Because amendatory changes included in the budget affect only the timeframe covered by the budget, this would require separate legislation.

Example: Under this option, resource/transfers would not be reflected in the outlook beyond the timeframe covered in the biennial budget, unless separate legislation specified the redirection/transfer addressing the timeframe beyond the biennial budget. Chapter 9, Laws of 2013, 2nd sp.s, (ESHB 2051) amended the statute to redirect the Public Utility Tax and a portion of the Real Estate Excise Tax from the Public Works Assistance Account to the ELTA through FY 2019.

Outlook: Updated Growth Factors

To: Economic and Revenue Forecast Council

From: State Budget Outlook Work Group

Subject: Growth factors for outlooks prepared for the 2015-17 biennium.

As discussed in previous meetings of the ERFC regarding the 4-year budget Outlook, the Outlook Work Group has developed alternative growth factors for the Outlook functional areas. These growth factors would be used for the Outlooks prepared during the 2015-17 biennium, that is from November 2014 through the outlook on the enacted 2016 supplemental budget in the summer of 2016. The growth factors would then be updated during the 2016 interim for the following biennium.

The attached table displays the current and revised growth factor rates.

Per statute, the estimated expenditures in the Outlook are to reflect the cost to continue current program, entitlement program growth, and actions required by law. The cost to continue current programs and growth in entitlement programs is estimated in the Outlook by using the growth factors. Other changes that are required by law, including items with future implementation dates, are generally reflected separately in the Outlook (e.g. Opportunity Scholarship or I-732). The Outlook statute specifically excludes any future costs related to policy items, collective bargaining agreements not approved by the Legislature, or salaries and benefits, unless required by statute.

Methodology Overview

The growth factors were updated through a joint effort by legislative and executive branch staff. The analysis used budgeted appropriations for the three accounts covered by the Outlook from the 2003-05 biennium to the 2013-15 biennium. Generally the approach compares the fiscal year change within each biennium through Maintenance Level of the budget. However given the nature of changes affecting K-12, Low-income health care, and debt service different methodologies were utilized. The specific approach in these areas is described below.

The analysis excluded items related to salaries and benefits, to ensure that growth associated with salary and benefit changes are not reflected in the growth factor. The items that are statutorily required (e.g. pensions and I-732) are calculated and displayed separately in the Outlook; therefore the growth factor does not include these items.

K-12 Education

The Outlook will handle K-12 in three components described below. Additionally, when new items are included in the K-12 budget, the Outlook will continue to reflect the school year to fiscal year adjustment.

Initiative 732 K-12 and Community College Staff Increases

Outlook: Updated Growth Factors

Funding for costs associated with providing cost of living increases to K-12 and certain community college staff pursuant to Initiative 732 (I-732) is calculated and displayed separately in the Outlook. The costs are revised in the Outlook with the updated I-732 inflationary factor.

Enrollment

The next component is the growth factor to reflect K-12 enrollment. The percentage is based on the most recent K-12 enrollment forecasted growth for the 15-16 school year through the 18-19 school year. The average enrollment growth over this timeframe is 0.66 percent per fiscal year.

Materials, Supplies and Operating Costs (MSOC)

The remaining component is adjusting the MSOC funding for statutorily required inflation. The Outlook will identify MSOC funding separately and will increase this amount by both the enrollment growth factor (0.66 percent) and the IPD.

Low Income Health Care

The growth for the Health Care Authority Medical Assistance program is based on actual and forecasted expenditures in core Medicaid programs from FY 2006 through FY 2015. Populations (e.g. Disability Lifeline) and services (e.g. dental) that have been subject to policy changes in the recent past were excluded from the analysis. Some of the major cost components for this area include utilization and medical inflation. The average growth over this timeframe is 3.22 percent per fiscal year.

Impacts of the expiration of the Hospital Safety Net and the Affordable Care Act (ACA) Federal match adjustment are calculated separately in the Outlook and not captured in the growth factor percentage.

DSHS Mental Health, Long Term Care, and Developmental Disabilities

The growth for Mental Health, Long Term Care and Developmental Disabilities is based on budget appropriations from the 2003-05 biennium to the 2013-15 biennium. Some of the major cost components include utilization and severity of client needs. The average growth over this timeframe is 3.42 percent per fiscal year.

The impacts of the Children's Mental Health Settlement, Nursing Home Re-Basing estimate, and Community First Choice Option are identified separately in the Outlook and not captured in the growth factor.

Higher Education

The growth for Higher Education is based on budget appropriations from the 2003-05 biennium to the 2013-15. The major cost components are changes in central service related charged and maintenance and operation costs for facilities. The average growth over this timeframe is 0.3 percent per fiscal year.

Outlook: Updated Growth Factors

The cost of College Bound, Opportunity Scholarships, and I-732 are shown separately in the Outlook and are not reflected in this growth rate.

Debt Service

The Debt Service analysis is based on the average annual future growth from the debt service model for the 2015-17 biennium through the 2021-23 biennium (8 fiscal years). The projected average growth is 4.43 percent per year over this timeframe.

Department of Corrections, DSHS Juvenile Rehabilitation and Special Commitment Center

The growth for Corrections, Juvenile Rehabilitation, and the Special Commitment Center is based on expenditures from the 2003-05 biennium to the 2013-15 biennium. A major cost component is the proportion of community and institution population. The average growth is estimated at 3.19 percent per fiscal year.

DSHS Children's Administration and Economic Services

The growth for Children's Administration and Economic Services is based on expenditures from the 2003-05 biennium to the 2013-15 biennium. Some of the major cost components include changes in the caseload and per capita costs for the foster care and adoption support programs, Working Connections Child Care, and TANF WorkFirst caseloads. The average growth over this timeframe is 1.93 percent per fiscal year.

The impacts of items with bow-waves such as the Working Connections Child Care rate increase or savings associated with the implementation of the electronic child care system DEL are captured separately in the Outlook and not reflected in this growth rate.

Other

This Outlook area includes general government agencies, judicially agencies, legislative agencies, and other human service agencies. The growth for Other Outlook area is based on expenditures from the 2003-05 biennium to the 2013-15 biennium. Major cost components in this area are related to fire suppression costs, central service charges, lease rate adjustments, and equipment replacement costs. The average growth is estimated at 0.53 percent per fiscal year.

The statutory transfer into the Public Safety Enhancement Account is identified separately in the Outlook and is not captured in the growth factor.

OUTLOOK GROWTH FACTORS

Outlook Groups <i>(in millions)</i>	Current Outlook Growth Factor	Revised Outlook Growth Factor (10 Yr. Avg.)	Difference
K-12 Enrollment	0.50%	0.66%	0.2%
K-12 MSOC**	0.50%	2.01%	1.5%
Low income health care	4.32%	3.22%	-1.1%
MH,DD, LTC*	2.00%	3.42%	1.4%
Higher Education	0.00%	0.30%	0.3%
Other	0.00%	0.53%	0.5%
Debt Service	6.00%	4.43%	-1.6%
DOC, JRA, SCC*	2.00%	3.19%	1.2%
ESA,CA*	2.00%	1.93%	-0.1%
I-732	N/A	N/A	N/A
Pensions	N/A	N/A	N/A
PEBB	N/A	N/A	N/A
Total			

Notes:

*Weights averages across programs in Outlook group based on the program budget size.

** MSOC is multiplied by enrollment and updated IPD, number reflects 1.35%

**Economic & Revenue Forecast Council
State of Washington**



Economic Review: September 4, 2014

Executive Summary

- The preliminary economic forecast is based on a modified version of Global Insight's August 2014 Control forecast for the U.S. economy. As usual, we have adjusted real gross domestic product (GDP) to match the Blue Chip "Consensus" GDP forecast. In the August Blue Chip release, the average forecast for real GDP growth in 2014 fell slightly to 2.1% from 2.2% in June, mainly as a result of an even larger decline in the first quarter than believed in June. The Blue Chip forecast for real GDP growth in 2015 has also been revised down slightly, from 3.1% to 3.0%. As in June, growth is expected to slow down after 2015 to 2.9%, 2.8%, 2.6%, and 2.5% in 2016 through 2019.
- The Blue Chip forecast was released prior to the August 28th GDP release in which second quarter growth was revised up from 4.0% (SAAR) to 4.2% (SAAR). The revised GDP estimate will be incorporated in the final September forecast.
- Our oil price forecast continues to rely on the futures markets, primarily the Brent (North Sea) oil price but also the West Texas Intermediate (WTI) benchmark. This forecast was based on the August 26, 2014 closing prices for Brent and WTI. The near-term futures prices for both WTI and Brent are lower than in June but they also decline less.
- Nonfarm employment increased by 209,000 jobs in July; May and June employment were revised up by a total of 15,000 jobs. Net new jobs have increased by over 200,000 in six consecutive months. Sectors with notable employment gains in July included manufacturing (+28,000), retail trade (+27,000), professional and technical services (+25,000), construction (+22,000), leisure and hospitality (+21,000), and social assistance (+18,000). The unemployment rate increased by 0.1 percentage points to 6.2%, largely because of more people entering the labor force to look for a job. August employment data will be available on September 5th and will be incorporated into the final economic forecast.
- The two major consumer confidence measures both increased in August. The Conference Board index of consumer confidence increased to 92.4 from 90.9 in July and is at its highest level since October 2007. The University of Michigan consumer sentiment survey rose to 82.5, 0.7 points higher than in July.
- Initial claims for unemployment insurance decreased by 1,000 to 298,000 (SA) in the week ending August 23rd. The four-week moving average for initial claims declined by 1,250 to 299,750.
- Light motor vehicle sales decreased slightly from 16.9 million units (SAAR) in June to 16.5 million units in July. Sales have now remained above 16 million units for five consecutive months.
- Industrial production increased by 0.4% in July (SA) compared to June and is 5.0% above its year-ago level. Growth in output in the motor vehicle, textiles

and apparel sectors was particularly strong, while utilities output declined in July. Manufacturing activity, as measured by the Institute for Supply Management's Purchasing Managers Index (PMI), increased to 59.0 in August (50 or higher indicates growth) from 57.1 in July. This is the index's highest reading since March 2011. The non-manufacturing PMI for July (the August data will be available September 4th) increased by 2.7 points to 58.7; non-manufacturing activity has now increased for 54 consecutive months.

- Recent housing data have been somewhat more positive. Housing units authorized by building permits in July increased 8.1% (SAAR) compared to their June level. This is 7.7% above housing permits for July 2013. Housing starts increased to 1.05 million units in July, 15.7% (SAAR) above the June rate. The pending home sales index, based on contract signings, was 3.3% (SAAR) higher in July than in June. The index has been at a level suggesting slightly higher than normal contract activity for three consecutive months. New single family home sales in July decreased by 2.4% (SAAR) compared to June, although they are 12.3% above July 2013 sales. Home prices have started to moderate, with the seasonally-adjusted Case-Shiller 20-city home price index showing small monthly decreases in April, May and June. However, the Case-Shiller index for June (SA) is still 6.2% above its year-ago level.
- Major threats to the U.S. and Washington economies remain, including slowing Asian economies (especially China), the possibility of a slowdown in the housing recovery, and the ongoing concern about slow growth and debt issues in Europe.

Washington

- In the two months since the June forecast was adopted the Washington economy added 17,900 jobs, 4,800 more than the 13,200 expected in the June forecast. As usual, most of the new jobs were in private services-providing industries which added 13,000 jobs in June and July. The manufacturing sector added 1,600 jobs in the two-month period thanks in part to an unexpected increase of 900 jobs in the aerospace industry. (We believe the increase in aerospace was due to temporary summer interns and will be reversed in the fall.) The construction sector added 2,300 jobs in June and July while federal, state, and local government combined added 900 jobs. The state's unemployment rate declined from 6.1% in May to 5.8% in June and 5.6% in July.
- We have also incorporated another quarter of Quarterly Census of Payrolls and Employment (QCEW) benchmark employment data. The new QCEW data and other revisions raised the estimated level of total employment in May 2014 by 8,000 jobs. As a result of the upward revisions to history and slightly stronger than expected growth, the total effect is 12,800 (0.4%) more jobs in July 2014 than expected in the June forecast.
- As in June, we assume a gradual decline in aerospace employment throughout the forecast. We continue to believe that this downturn will be relatively mild due to the large and increasing backlog of orders. The current reductions are due to improvements in productivity rather than reductions in production.

- The Institute of Supply Management - Western Washington Index (ISM-WW) plummeted to 50.1 in July from 67.0 in June (index values above 50 indicate positive growth while values below 50 indicate contractions). The July figure was the weakest since July 2009, at the depth of the recession. The production, orders, employment, and inventory components all worsened in July. Only the deliveries index improved.
- In late June, the Bureau of Economic Analysis released estimates for state personal income through the first quarter of 2014. We have incorporated the new BEA estimates as well as additional Washington QCEW and other wage data through the first quarter. Our current estimate of Washington personal income in the first quarter of 2014 is \$337.9 billion which is \$0.3 billion (0.1%) higher than assumed in June. However, monthly U.S. personal income growth, a key driver of the Washington personal income estimates, has been stronger than expected so far in 2014, mostly in the transfer payments component. As a result, our estimate for personal income in the second quarter was \$0.9 billion (0.3%) more than expected in June.
- Single-family housing construction was once again weaker than expected in the second quarter of 2014 according to the building permit data but overall construction was close thanks to stronger-than-expected multi-family construction. Total housing units authorized by building permits averaged 37,200 (SAAR) in April, May, and June. The June forecast had assumed 37,400 units. Single-family units averaged 16,600, 800 less than expected but multi-family units averaged 20,600, 600 more than expected.
- According to the S&P/Case-Shiller Home Price Indices, seasonally adjusted Seattle area home prices rose 0.2% in June following a 0.3% decline in May. The dip in May was the first decrease since November 2011 and followed 29 consecutive monthly increases. Seattle home prices are still up 8.6% over the previous June and are 26.2% higher than the November 2011 trough.
- Washington car sales reached a new post-recession high in July 2014. New vehicle registrations totaled of 290,800 (SAAR) in July, 1.1% more than in June and 5.7% more than in July 2013. July's new vehicle registrations were the strongest since November 2007, before the onset of the recession.
- Washington exports increased 11.9% in the second quarter of 2014 compared to the second quarter of 2013. Exports of transportation equipment (mostly Boeing planes) increased 10.4% over the year and exports of agricultural products jumped 62.5% over the year. Exports of all other Washington commodities rose 4.6% over the year.
- Seattle shelter costs continue to rise much more rapidly than U.S. city average shelter costs but other prices are rising much more slowly, with the result that headline inflation in Seattle is close to the national average. The Seattle CPI rose 2.0% from June 2013 to June 2014 compared to 2.1% for the U.S. city average. Similarly, core prices increased 1.8% in Seattle compared to 1.9% for the nation. However, shelter costs rose 5.1% over the year in Seattle compared to 2.8% for the U.S. city average. All items excluding shelter rose only 0.6% in Seattle compared to the national average increase of 1.7%.
- Overall, our preliminary September forecast for Washington State is similar to the forecast adopted in June. Washington employment growth is expected to grow 2.6% this year compared to 2.3% assumed in the June forecast. The

upward revision to growth in 2014 is mostly due to higher historical employment data through July. The September forecast for average annual employment growth from 2015 through 2019 is now 1.6% per year, up slightly from the 1.5% growth rate forecasted in June. Our September forecast for nominal personal income growth this year of 4.7% is slightly stronger than the June forecast of 4.4%. However, our new forecast for nominal personal income growth from 2015 through 2019 averages 5.4% per year, the same rate as predicted in June.

Washington State Economic Outlook & Revenue Collection Experience

Presented to
The Economic & Revenue Forecast Council

Steve Lerch
Executive Director

September 4, 2014
Olympia, Washington



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ECONOMIC AND REVENUE FORECAST COUNCIL**

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Summary

- The economic forecast is quite similar to June
- Washington employment has been slightly stronger than expected in June
- Risks to the baseline include the potential for slower Chinese economic growth, possible disruptions to the housing recovery, and geopolitical unrest
- Adjusted revenue collections since the June forecast are \$89.3 million (3.5%) above expectations
- The Washington economy continues to grow slowly, with employment rising in most sectors

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Three major risks to the forecast



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Source: ERFC

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Slowdown in manufacturing activity could signal lower Chinese economic growth



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Source: National Bureau of Statistics of China; data through August 2014

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Housing starts are trending up but remain below historic average



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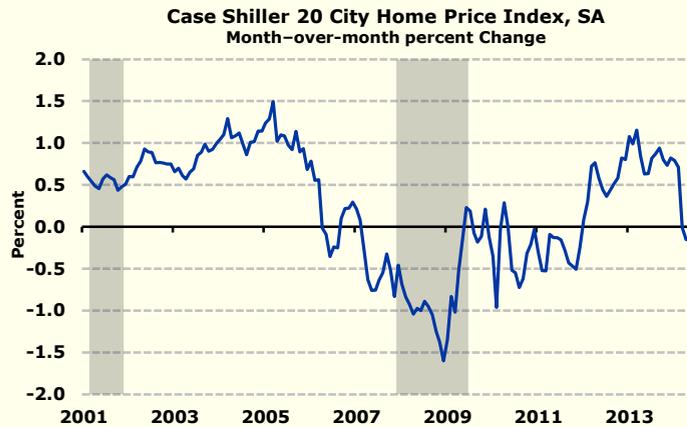
Source: U.S. Census; data through July 2014

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Home prices are starting to moderate



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Source: U.S. Composite-20, S&P/Case-Shiller; data through June 2014

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European unemployment remains high



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Source: Eurostat, Centre for Economic Policy Research; data through July 2014

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Small business optimism and sales expectations are weak but improving



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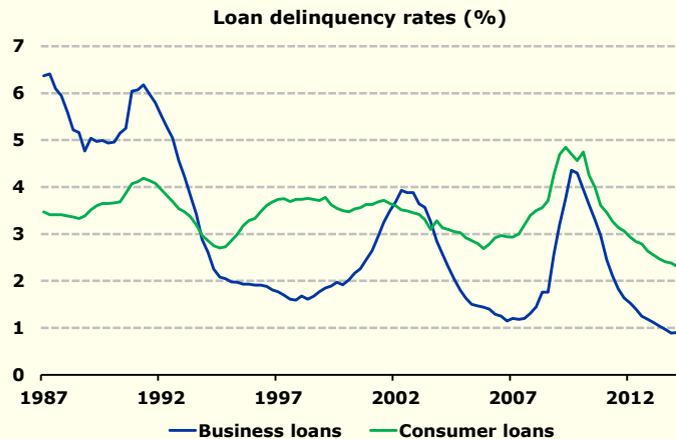
Source: National Federation of Independent Business; data through July 2014

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Delinquency rates for business and consumer loans have dropped



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Source: Federal Reserve; SA data through 2014 Q2

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Average U.S. wage growth is barely outpacing inflation

Year-over-year growth in U.S. real hourly wages



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Source: U.S. Bureau of Labor Statistics, data through July 2014

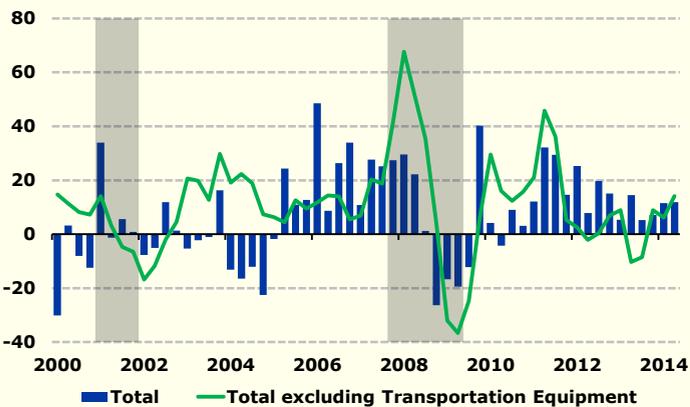
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Non-transportation equipment export growth is back in positive territory

Washington Exports
Percent Change, year ago



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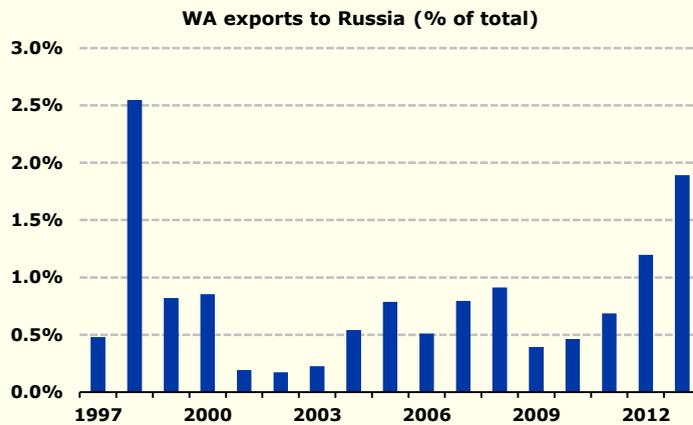
Source: Wisier Trade Data; through 2014Q2

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Russia has typically accounted for less than 1% of state exports



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Source: WISERTrade, data through 2013

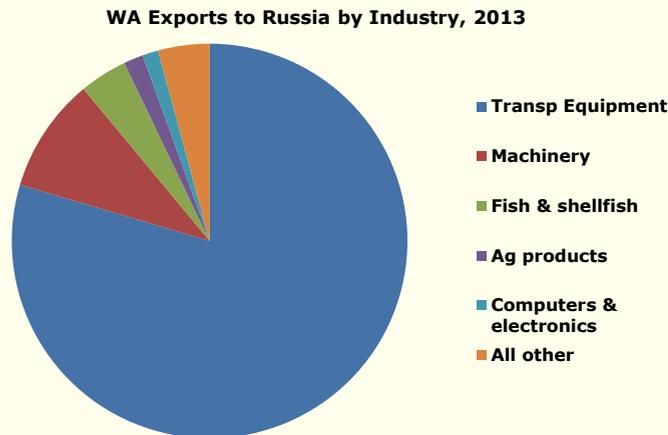
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Aerospace accounts for most state exports to Russia

As of July 2014, Boeing has 92 unfilled orders from Russia



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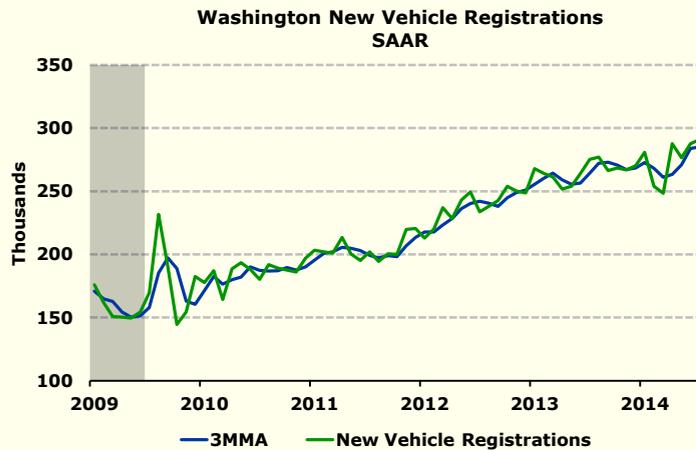
Source: WISERTrade

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Washington new vehicle registrations have resumed growth



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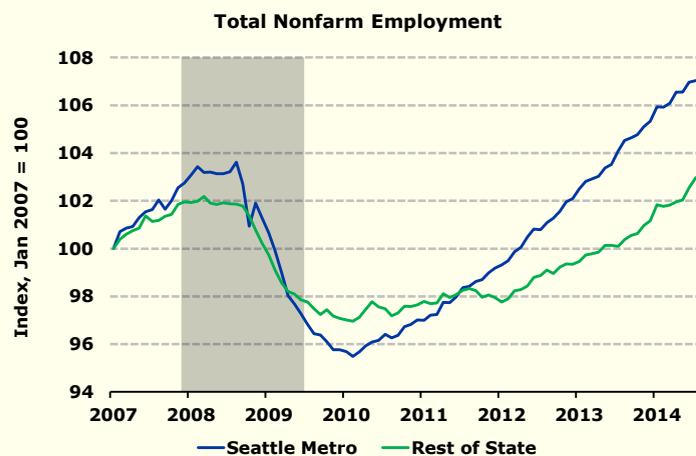
Source: Dept. of Licensing, ERFC; data through July 2014

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Seattle area employment is growing much faster than the rest of the state



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Source: Employment Security Department, ERFC; data through July 2014

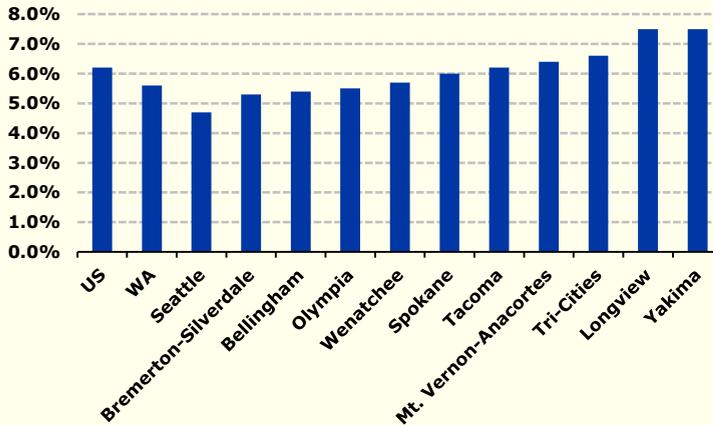
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Seven of eleven WA metro areas have unemployment rates below national level

July unemployment rate



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Source: Employment Security Dept., July 2014 data

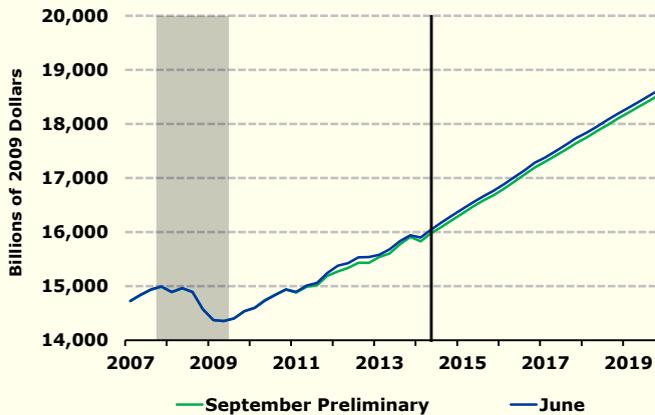
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GDP growth is quite similar to the June forecast

Real GDP



Level of GDP is lower due to annual data revision

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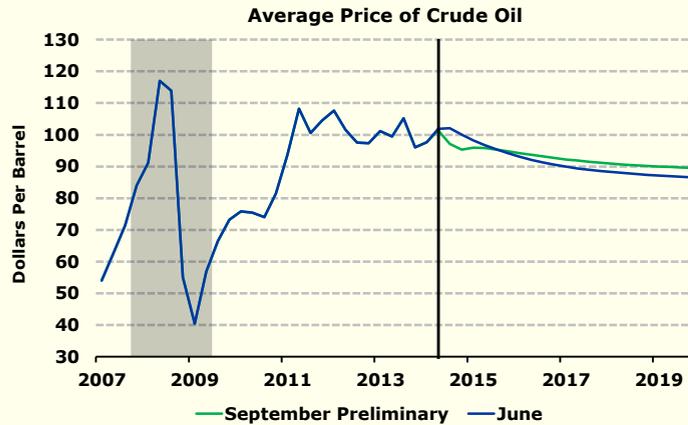
Source: Global Insight, ERFC September 2014 Preliminary forecast; historical data through 2014Q2

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Oil prices lower in the near term but decline less than in June



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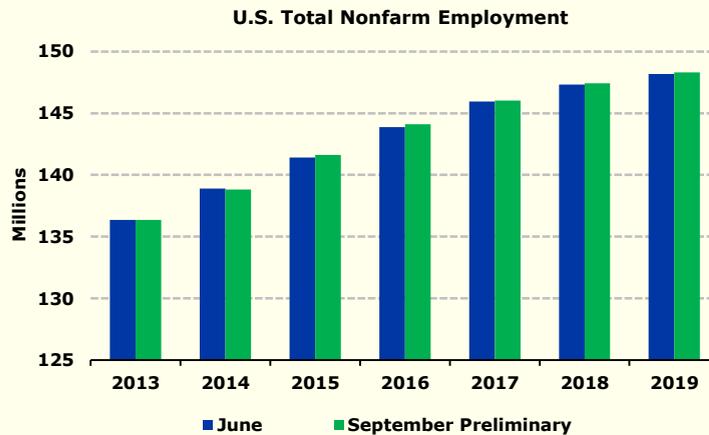
Source: DOE, ERFC September 2014 Preliminary forecast; historical data through 2014Q2

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U.S. employment forecast essentially unchanged



Economic Review
September 4, 2014

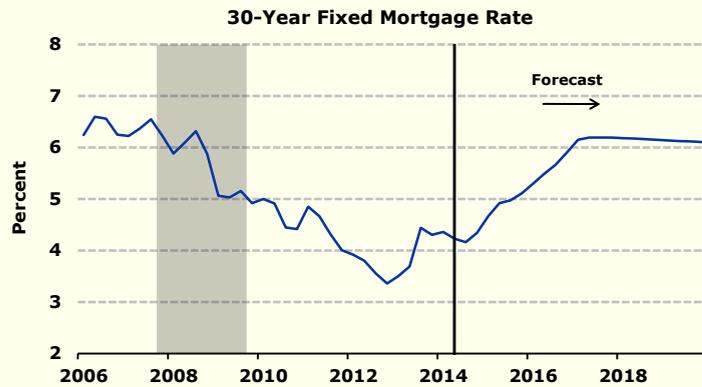
Source: BEA, ERFC; historical data through 2013

Slide 18

WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



After a slight dip this year, mortgage rates are expected to increase



Economic Review
September 4, 2014

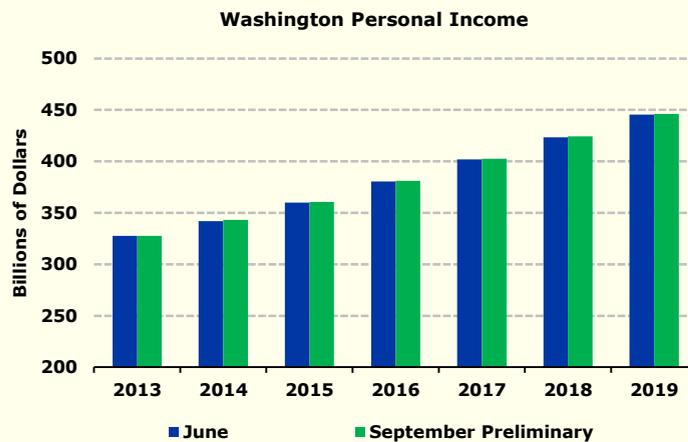
Source: ERFC September 2014 Preliminary forecast; historical data through 2014Q2

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WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Washington personal income forecast is essentially unchanged



Economic Review
September 4, 2014

Source: ERFC September 2014 Preliminary forecast; historical data through 2013

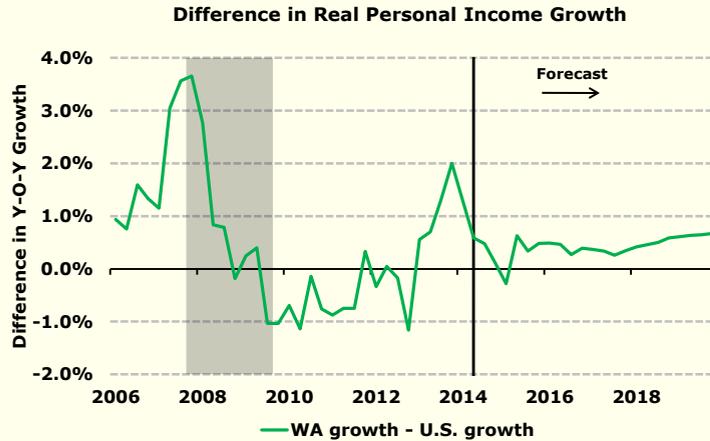
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WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



State personal income will grow slightly faster than the U.S.

Slower WA growth in 2015Q1 reflects impact of 2014Q1 Boeing bonus



Economic Review
September 4, 2014

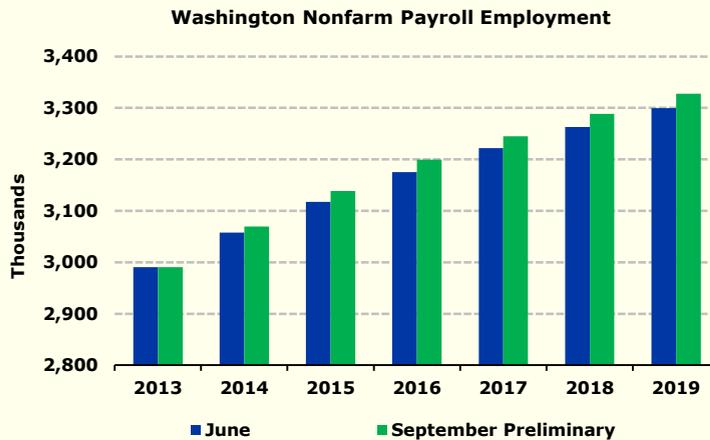
Source: ERFC September 2014 Preliminary forecast; historical data through 2014Q2

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WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Washington employment forecast revised up



Economic Review
September 4, 2014

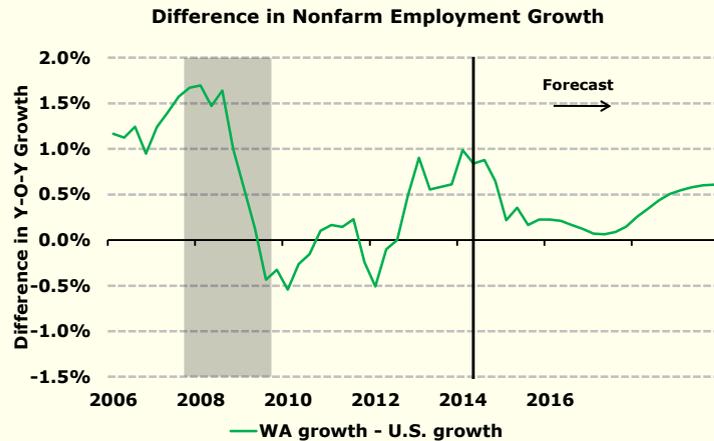
Source: ERFC September 2014 Preliminary forecast; historical data through 2013

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WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Washington employment will grow slightly faster than the U.S.



Economic Review
September 4, 2014

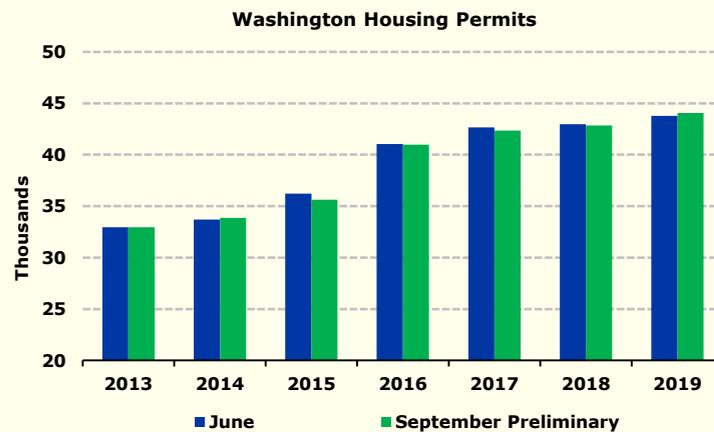
Source: ERFC September 2014 Preliminary forecast; historical data through 2014Q2

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WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Washington housing permits forecast is slightly lower in 2015-2018



Economic Review
September 4, 2014

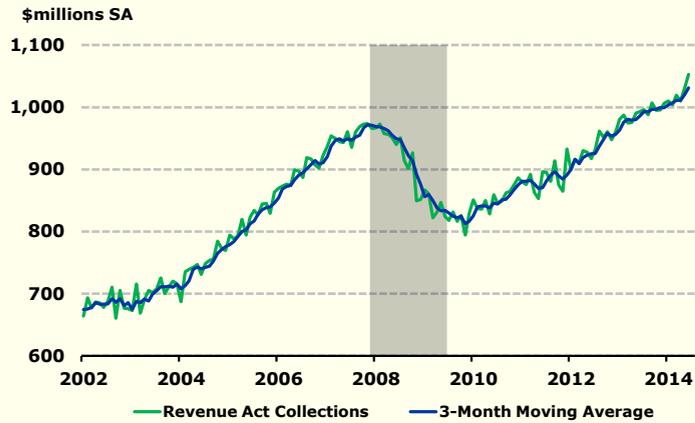
Source: ERFC September 2014 Preliminary forecast; historical data through 2013

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WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Seasonally adjusted Revenue Act collections growth increased in Q2



Economic Review
September 4, 2014

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* Adjusted for large one-time transactions, amnesty payments and reporting frequency change, current definition of Revenue Act

Source: DOR and ERFC; monthly data through estimated June 2014 activity

WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Sales tax growth was strong in the second quarter

Adjusted sales tax collections were up 4.6% year-over-year for 1st quarter activity and 8.5% for 2nd quarter activity.

Preliminary estimates of June activity were up 7.4% year-over-year



Economic Review
September 4, 2014

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Adjusted for large payments/refunds, amnesty payments and taxpayer reporting frequency change

Source: ERFC; Monthly data through June 2014 preliminary activity

WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Revenue collections to date

Most of the forecast variance was the result of a \$55.4 million positive variance in Revenue Act collections in the July 11-August 10 collection period.

Cumulative Variance Since June Forecast (June 11 – August 10, 2014) dollars in thousands

	<u>Estimate</u>	<u>Actual</u>	<u>Difference</u>	<u>Pct.</u>
Dept. of Revenue	\$2,524,684	\$2,613,987	\$89,304	3.5%
All other agencies	\$22,906	\$22,947	\$41	0.2%
Total GF-S	\$2,547,590	\$2,636,934	\$89,345	3.5%

Economic Review
September 4, 2014

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WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL



Conclusion

- The economic forecast is quite similar to June's forecast; we expect the slow pace of economic recovery to continue in both the U.S. and Washington economies
- Washington is still likely to outperform the nation, but by a small margin
- Threats to economic recovery include the potential for slower Chinese economic growth, possible disruptions to the housing recovery, and a geopolitical unrest
- The next monthly collection report will be available on September 11th and the revenue forecast will be presented on September 16th

Economic Review
September 4, 2014

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WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL

U.S. Economic Forecast Comparison

August 2014

	2014Q2	2014Q3	2014Q4	2015Q1	2014	2015	2016	2017	2018	2019
Real GDP, Percent Change, Annual Rate										
ERFC Preliminary September	4.0	2.8	3.1	3.1	2.1	3.0	2.9	2.8	2.6	2.5
Global Insight	4.0	3.6	2.5	2.6	2.1	2.8	3.4	3.3	2.7	2.6
Economy.com	3.9	3.1	3.2	3.4	2.1	3.5				
Blue Chip Average*		2.9	3.0	2.9	2.1	3.0	2.9	2.8	2.6	2.5
Blue Chip Top 10*		3.4	3.6	3.5	2.2	3.4	3.3	3.1	3.0	2.9
Blue Chip Bottom 10*		2.3	2.5	2.3	1.9	2.6	2.4	2.4	2.1	2.1
Real Consumption, Percent Change, Annual Rate										
ERFC Preliminary September	2.5	2.6	2.9	3.0	2.3	2.8	2.7	2.6	2.5	2.4
Global Insight	2.5	2.2	2.8	3.0	2.3	2.8	3.3	3.4	2.9	2.5
Economy.com	2.5	2.8	3.5	4.0	2.4	3.8				
Blue Chip Average*		2.7	2.8	2.8	2.3	2.8	2.7	2.6	2.5	2.4
Blue Chip Top 10*		3.1	3.3	3.4	2.5	3.3	3.1	3.0	2.9	2.7
Blue Chip Bottom 10*		2.2	2.3	2.2	2.2	2.4	2.2	2.3	2.1	2.0
Federal Funds Rate										
ERFC Preliminary September	0.1	0.1	0.1	0.1	0.1	0.3	2.0	3.6	3.8	3.8
Global Insight	0.1	0.1	0.1	0.1	0.1	0.3	2.0	3.6	3.8	3.8
Economy.com	0.1	0.1	0.1	0.1	0.1	0.3				
Three Month T-Bill Rate										
ERFC Preliminary September	0.0	0.0	0.1	0.1	0.0	0.1	0.1	0.2	0.4	0.6
Global Insight	0.0	0.0	0.1	0.1	0.0	0.1	0.1	0.2	0.4	0.6
Blue Chip Average*		0.1	0.1	0.2	0.1	0.5	0.1	0.1	0.1	0.1
Blue Chip Top 10*		0.1	0.2	0.3	0.1	0.9	0.2	0.2	0.2	0.2
Blue Chip Bottom 10*		0.0	0.0	0.1	0.0	0.2	0.1	0.1	0.1	0.1
10-Yr. T-Note Yield										
ERFC Preliminary September	2.6	2.6	2.7	3.0	2.7	3.2	3.7	4.2	4.2	4.1
Global Insight	2.6	2.6	2.8	3.1	2.7	3.3	3.7	4.2	4.2	4.2
Economy.com	2.6	2.5	2.9	3.2	2.7	3.6				
Blue Chip Average*		2.7	2.9	3.1	2.7	3.4	1.9	2.9	3.3	3.5
Blue Chip Top 10*		2.8	3.2	3.5	2.9	3.8	3.1	4.0	4.2	4.3
Blue Chip Bottom 10*		2.5	2.6	2.8	2.6	3.0	0.8	1.5	2.1	2.3
Consumer Price Index, Percent Change, Annual Rate										
ERFC Preliminary September	3.0	1.5	0.8	2.0	1.8	1.5	1.5	1.8	1.7	1.5
Global Insight	3.0	1.9	1.4	1.7	1.9	1.6	1.6	1.9	2.0	1.9
Economy.com	3.0	1.9	2.0	2.3	1.9	2.2				
Blue Chip Average*		2.2	2.0	2.0	2.0	2.1	2.2	2.3	2.4	2.3
Blue Chip Top 10*		2.9	2.6	2.6	2.1	2.6	2.6	2.7	2.8	2.8
Blue Chip Bottom 10*		1.6	1.2	1.3	1.9	1.7	1.9	2.0	2.1	2.0
Payroll Employment, Millions										
ERFC Preliminary September	138.5	139.1	139.9	140.6	138.8	141.6	144.1	146.0	147.4	148.3
Percent Change, Annual Rate	2.2	1.8	2.1	2.1	1.8	2.0	1.8	1.3	0.9	0.6
Global Insight	138.5	139.2	139.9	140.6	138.9	141.5	144.3	146.7	148.4	149.4
Percent Change, Annual Rate	2.2	2.1	2.0	1.9	1.8	1.9	1.9	1.7	1.1	0.7
Economy.com	138.5	139.2	140.0	140.8	138.9	142.2				
Percent Change, Annual Rate	2.2	2.1	2.3	2.4	1.8	2.4				
Unemployment Rate, Percent										
ERFC Preliminary September	6.2	6.2	6.1	5.9	6.3	5.8	5.6	5.6	5.5	5.4
Global Insight	6.2	6.1	6.0	5.9	6.3	5.8	5.5	5.2	5.1	5.0
Economy.com	6.2	6.1	6.0	5.9	6.3	5.7				
Blue Chip Average*		6.1	6.0	5.9	6.3	5.7	5.6	5.4	5.3	5.3
Blue Chip Top 10*		3.2	6.1	6.1	6.3	6.0	6.0	5.8	5.8	5.7
Blue Chip Bottom 10*		6.1	5.8	5.7	6.2	5.4	5.3	5.0	4.9	4.8
Real Disposable Personal Income, Percent Change, Annual Rate										
ERFC Preliminary September	3.8	2.3	2.0	3.6	2.5	2.9	3.8	3.8	3.4	3.1
Global Insight	3.8	2.2	1.7	3.7	2.5	2.8	4.0	4.1	3.4	3.0
Blue Chip Average*		2.5	2.7	2.9	2.5	2.8	2.9	2.9	2.7	2.6
Blue Chip Top 10*		3.4	3.2	3.9	2.8	3.3	3.9	3.7	3.4	3.3
Blue Chip Bottom 10*		1.5	2.1	2.2	2.1	2.4	2.2	2.3	2.2	2.1

* Forecasts beyond 2015 are from the March 2014 Blue Chip Economic Indicators

U.S. Forecast Comparison	Fiscal Years					
	2014	2015	2016	2017	2018	2019
Real GDP						
Billions of 2009 dollars						
September Preliminary Forecast	15,878	16,283	16,748	17,245	17,701	18,155
<i>Growth</i>	2.4%	2.5%	2.9%	3.0%	2.6%	2.6%
June Forecast	16,002	16,461	16,935	17,404	17,866	18,319
<i>Growth</i>	2.7%	2.9%	2.9%	2.8%	2.7%	2.5%
Difference in level	-124	-178	-187	-159	-165	-164
Difference in growth forecast	-0.3%	-0.3%	0.0%	0.2%	0.0%	0.0%
Real Consumption						
Billions of 2009 dollars						
September Preliminary Forecast	10,820	11,101	11,404	11,709	12,010	12,301
<i>Growth</i>	2.4%	2.6%	2.7%	2.7%	2.6%	2.4%
June Forecast	10,864	11,176	11,474	11,772	12,076	12,373
<i>Growth</i>	2.3%	2.9%	2.7%	2.6%	2.6%	2.5%
Difference in level	-44	-75	-70	-63	-66	-72
Difference in growth forecast	0.1%	-0.3%	0.1%	0.1%	0.0%	0.0%
Implicit Price Deflator						
Index 2009 = 100						
September Preliminary Forecast	108.1	109.6	111.1	112.8	114.5	116.2
<i>Growth</i>	1.3%	1.4%	1.3%	1.5%	1.6%	1.4%
June Forecast	107.7	109.2	110.6	112.1	113.6	115.0
<i>Growth</i>	1.0%	1.3%	1.3%	1.3%	1.4%	1.3%
Difference in level	0.3	0.4	0.5	0.7	0.9	1.2
Difference in growth forecast	0.2%	0.1%	0.0%	0.2%	0.2%	0.2%
Unemployment Rate						
Percent of Labor Force						
September Preliminary Forecast	6.8%	6.0%	5.6%	5.6%	5.5%	5.5%
June Forecast	6.8%	6.2%	5.8%	5.6%	5.5%	5.4%
Difference in forecast	0.0%	-0.2%	-0.2%	-0.1%	0.0%	0.0%
30 Year Fixed Mortgage Rate						
Annual Average						
September Preliminary Forecast	4.3%	4.5%	5.2%	6.0%	6.2%	6.1%
June Forecast	4.4%	4.8%	5.3%	6.2%	6.6%	6.6%
Difference in forecast	-0.1%	-0.3%	-0.1%	-0.2%	-0.4%	-0.4%
3 Month T-Bill Rate						
Annual Average						
September Preliminary Forecast	0.0%	0.1%	1.0%	2.9%	3.5%	3.5%
June Forecast	0.1%	0.1%	1.2%	3.1%	3.7%	3.7%
Difference in forecast	0.0%	0.0%	-0.1%	-0.2%	-0.2%	-0.2%

Washington Forecast Comparison	Fiscal Years					
	2014	2015	2016	2017	2018	2019
Real Personal Income						
Billions of 2009 dollars						
September Preliminary Forecast	310.4	320.5	333.6	347.5	360.9	374.5
<i>Growth</i>	2.7%	3.3%	4.1%	4.2%	3.9%	3.8%
June Forecast	310.4	322.3	334.6	347.6	360.8	373.5
<i>Growth</i>	2.6%	3.9%	3.8%	3.9%	3.8%	3.5%
Difference in level	0.0	-1.8	-1.0	-0.1	0.1	0.9
<i>Difference in growth forecast</i>	0.1%	-0.6%	0.3%	0.3%	0.0%	0.2%
Nominal Personal Income						
Billions of dollars						
September Preliminary Forecast	335.4	351.3	370.6	391.9	413.4	435.2
<i>Growth</i>	4.0%	4.8%	5.5%	5.7%	5.5%	5.3%
June Forecast	334.3	351.9	370.2	389.6	409.9	429.7
<i>Growth</i>	3.6%	5.2%	5.2%	5.2%	5.2%	4.8%
Difference in level	1.1	-0.5	0.5	2.3	3.5	5.5
<i>Difference in growth forecast</i>	0.4%	-0.5%	0.3%	0.5%	0.3%	0.4%
Nonfarm Payroll Employment, End of Period						
Thousands						
September Preliminary Forecast	3,029.6	3,104.9	3,170.0	3,224.1	3,266.7	3,308.9
<i>Growth</i>	2.5%	2.5%	2.1%	1.7%	1.3%	1.3%
June Forecast	2,970.1	3,030.0	3,093.6	3,150.0	3,196.5	3,235.7
<i>Growth</i>	2.2%	2.0%	2.1%	1.8%	1.5%	1.2%
Difference in level	59.5	74.9	76.4	74.0	70.2	73.2
<i>Difference in growth forecast</i>	0.3%	0.5%	0.0%	-0.1%	-0.2%	0.1%
Housing Permits						
Units Authorized, Thousands						
September Preliminary Forecast	33.7	34.0	38.4	42.2	42.5	43.3
<i>Growth</i>	7.7%	0.9%	13.0%	10.1%	0.6%	1.9%
June Forecast	31.6	35.4	39.9	41.6	42.1	42.9
<i>Growth</i>	2.7%	11.9%	12.7%	4.3%	1.1%	1.9%
Difference in level	2.0	-1.5	-1.5	0.6	0.4	0.4
<i>Difference in growth forecast</i>	5.0%	-11.1%	0.3%	5.7%	-0.4%	0.0%

**Year-Over-Year Employment Growth by Industry
(July 2013 to July 2014)
Washington vs. U.S.**

	Washington		U.S.
	(000)	% Chg.	% Chg.
Total	84.3	2.8%	1.9%
Construction	12.2	8.2%	3.6%
Mining and Logging	0.4	6.5%	5.6%
Information Excluding Software	2.3	4.3%	NA
Professional and Business Services	13.3	3.7%	3.5%
Leisure and Hospitality	10.6	3.7%	2.6%
Wholesale Trade	4.3	3.4%	2.2%
Retail Trade	11.2	3.4%	2.0%
Education and Health Services	13.5	3.1%	1.8%
Software Publishers	1.4	2.7%	NA
Transportation, Warehousing and Utilities	2.3	2.4%	2.9%
Manufacturing Excluding Aerospace	4.0	2.1%	NA
Other Services	2.1	1.9%	0.9%
State and Local Gov Education	4.4	1.9%	0.8%
State and Local Gov Non-Education	2.9	1.4%	0.8%
Financial Activities	1.8	1.2%	0.7%
Aerospace Product and Parts Manufacturing	-2.3	-2.4%	NA
Information	3.7	3.5%	-1.0%
Manufacturing	1.7	0.6%	1.5%

Source: WA State ERFC Kalman filtered data, U.S. Bureau of Labor Statistics

**County Taxable Retail Sales
Quarter 1, 2013 to Quarter 1, 2014
(Dollars in Thousands)**

Rank	County	1st Quarter, 2013	1st Quarter, 2014	Percent Change	Taxbase Distribution
1	Columbia	14,585	25,214	72.9%	0.1%
2	Klickitat	40,536	52,770	30.2%	0.2%
3	San Juan	59,639	69,771	17.0%	0.3%
4	Pend Oreille	29,869	34,478	15.4%	0.1%
5	Cowlitz	298,002	336,381	12.9%	1.2%
6	Okanogan	101,391	113,277	11.7%	0.4%
7	Grays Harbor	178,252	195,194	9.5%	0.7%
8	Kittitas	144,676	158,280	9.4%	0.6%
9	Ferry	8,518	9,266	8.8%	0.0%
10	Island	162,092	175,707	8.4%	0.6%
11	Chelan	277,156	300,196	8.3%	1.1%
12	Clark	1,070,976	1,156,100	7.9%	4.2%
13	Stevens	73,010	78,608	7.7%	0.3%
14	Yakima	714,301	764,428	7.0%	2.8%
15	King	10,265,549	10,943,896	6.6%	40.1%
16	Spokane	1,652,727	1,740,041	5.3%	6.4%
17	Douglas	164,453	173,126	5.3%	0.6%
	Statewide	25,985,555	27,265,889	4.9%	100.0%
18	Adams	57,237	59,953	4.7%	0.2%
19	Kitsap	736,296	770,882	4.7%	2.8%
20	Franklin	252,665	264,225	4.6%	1.0%
21	Pierce	2,784,665	2,891,986	3.9%	10.6%
22	Walla Walla	164,125	169,674	3.4%	0.6%
23	Snohomish	2,499,143	2,579,542	3.2%	9.5%
24	Skamania	17,198	17,738	3.1%	0.1%
25	Lewis	234,870	241,993	3.0%	0.9%
26	Asotin	57,804	59,449	2.8%	0.2%
27	Mason	110,710	113,723	2.7%	0.4%
28	Skagit	506,437	517,780	2.2%	1.9%
29	Lincoln	21,740	22,164	2.0%	0.1%
30	Clallam	203,287	206,336	1.5%	0.8%
31	Wahkiakum	6,662	6,692	0.5%	0.0%
32	Benton	715,433	715,827	0.1%	2.6%
33	Whatcom	757,059	754,897	-0.3%	2.8%
34	Whitman	138,427	137,805	-0.4%	0.5%
35	Pacific	47,570	46,827	-1.6%	0.2%
36	Thurston	932,883	908,482	-2.6%	3.3%
37	Jefferson	86,313	81,362	-5.7%	0.3%
38	Grant	393,721	367,562	-6.6%	1.3%
39	Garfield	5,580	4,254	-23.8%	0.0%

King/Snohomish/Pierce	15,549,357	16,415,424	5.6%	60.2%
Remainder of State	10,436,198	10,850,465	4.0%	39.8%

Governor's Council of Economic Advisor's Forecast
September 4, 2014

Calendar Years

	2014	2015	2016	2017	2018	2019
U.S.						
Real GDP						
<i>Growth</i>						
ERFC	2.1	3.0	2.9	2.8	2.6	2.5
GCEA Average	2.2	2.9	2.8	2.6	2.4	2.4
Real Consumption						
<i>Growth</i>						
ERFC	2.3	2.8	2.7	2.6	2.5	2.4
GCEA Average	2.3	2.8	2.6	2.6	2.4	2.3
Implicit Price Deflator, PCE						
<i>Growth</i>						
ERFC	1.4	1.4	1.4	1.6	1.5	1.4
GCEA Average	1.6	1.7	1.8	1.8	1.8	1.8
Mortgage Rate						
<i>Percent</i>						
ERFC	4.3	4.9	5.6	6.2	6.2	6.1
GCEA Average	4.3	4.9	5.5	6.0	6.0	5.9
Oil Price (Brent)						
<i>Dollars per barrel</i>						
ERFC	106.2	104.1	102.0	99.8	98.2	97.2
GCEA Average	105.5	102.0	99.6	98.4	97.6	97.1

In what quarter will the Fed begin raising rates? 2015Q2-80%, 2015Q3-20%

Washington State

Real Personal Income

<i>Growth</i>						
ERFC	3.3	3.6	4.3	4.0	3.8	3.7
GCEA Average	3.3	3.4	3.6	3.4	3.3	3.2

Wage and Salary Employment

<i>Growth</i>						
ERFC	2.6	2.3	1.9	1.4	1.3	1.2
GCEA Average	2.4	2.2	1.8	1.5	1.4	1.3

Manufacturing Employment

<i>Growth</i>						
ERFC	0.6	1.6	1.2	0.4	0.5	0.5
GCEA Average	0.8	1.2	0.8	0.3	0.2	0.2

Construction Employment

<i>Growth</i>						
ERFC	7.2	5.3	6.1	5.2	4.7	3.1
GCEA Average	6.2	4.6	4.9	4.5	3.6	2.9

Housing Permits

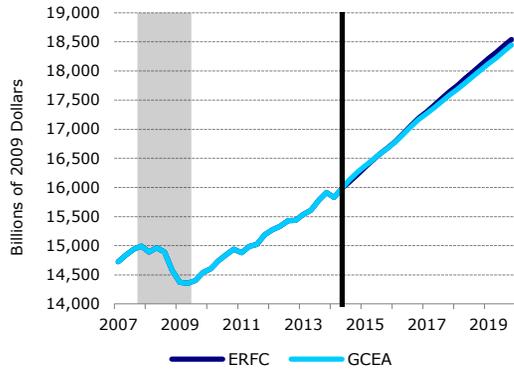
<i>Thousands of authorized units</i>						
ERFC	33.9	35.6	41.0	42.4	42.8	44.1
GCEA Average	33.9	37.6	42.9	42.9	43.4	44.3

Washington Average Annual Wage

<i>Growth</i>						
ERFC	2.9	2.4	3.4	3.4	3.5	3.7
GCEA Average	2.8	2.8	3.2	3.2	3.3	3.4

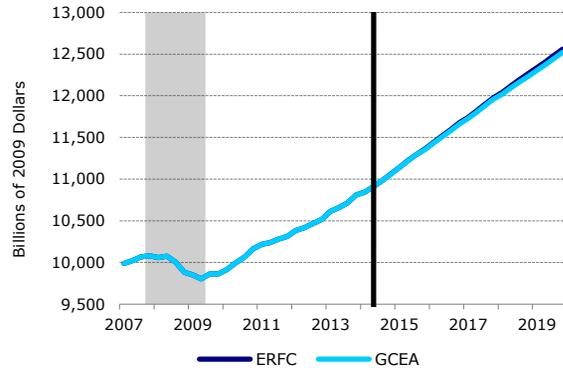
U.S. Forecast Comparison

Real GDP



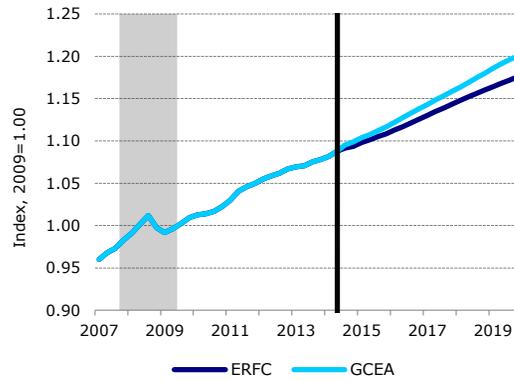
Source: BEA, ERFC, GCEA; data through 2014 Q2

Real Consumption



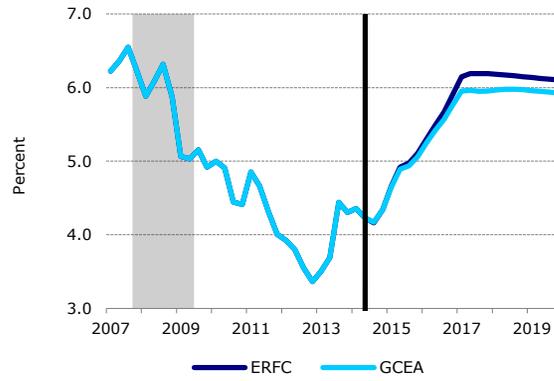
Source: BEA, ERFC, GCEA; data through 2014 Q2

Implicit Price Deflator, PCE



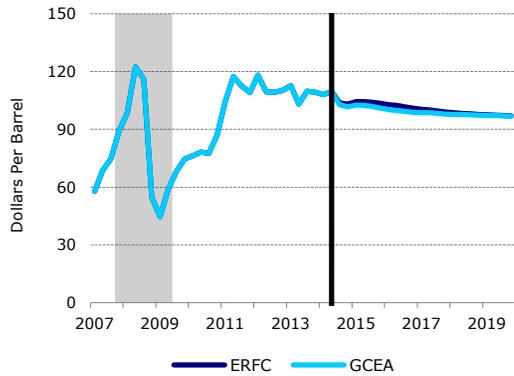
Source: BEA, ERFC, GCEA; data through 2014 Q2

Mortgage Rate



Source: Freddie Mac, ERFC, GCEA; data through 2014 Q2

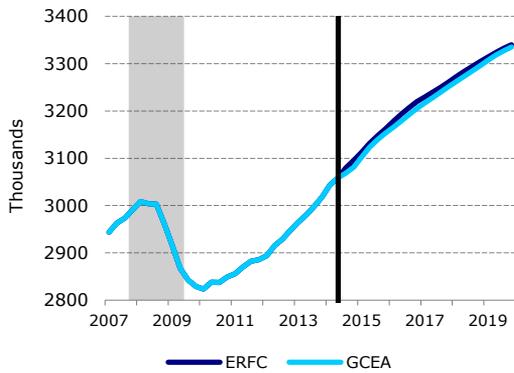
Brent Oil Price



Source: EIA, ERFC, GCEA; data through 2014 Q2

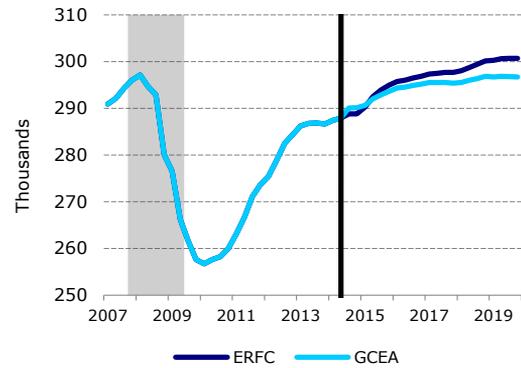
Washington Forecast Comparison

Nonfarm Payroll Employment



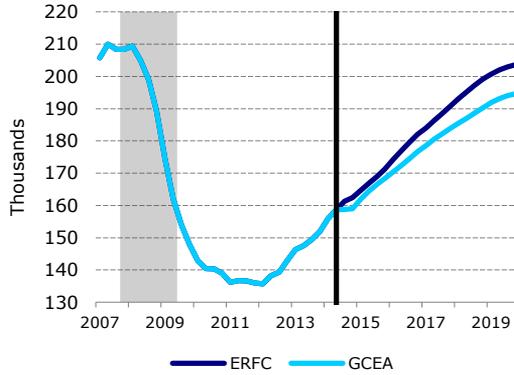
Source: ESD, ERFC, GCEA; data through 2014 Q2

Manufacturing Employment



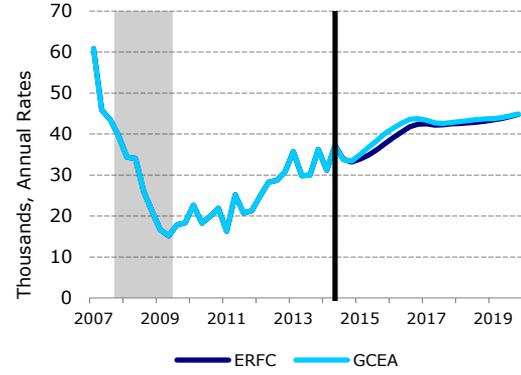
Source: ESD, ERFC, GCEA; data through 2014 Q2

Construction Employment



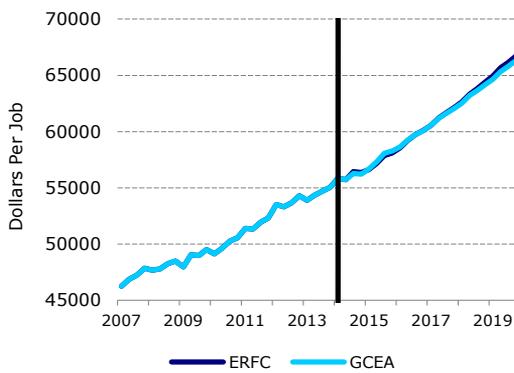
Source: ESD, ERFC, GCEA; data through 2014 Q2

Housing Units Authorized



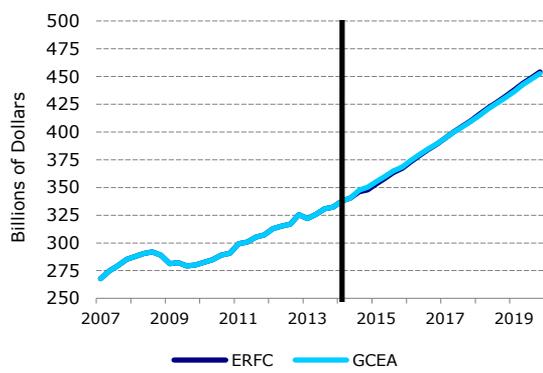
Source: Census, ERFC, GCEA; data through 2014 Q2

Average Annual Wage



Source: BEA, ERFC, GCEA; data through 2014 Q1

Personal Income



Source: BEA, ERFC, GCEA; data through 2014 Q1